

- 1.7 This Operating Practice provides definitions, regulatory requirements, assignment of responsibilities for nontariffed activities, contract coordination contacts and affiliate transaction rules in order to assist SWBT personnel entering into contracts for the provision of these activities in following the requirements for these contracts.
- 1.8 The contracts referred to in this Operating Practice should be interpreted to include any oral or written agreements in which nontariffed activities are provided by SWBT to both affiliated and non-affiliated outside entities. This Operating Practice does not cover purchase contracts, with the exception of transactions with affiliates, as covered in this Operating Practice in Section 10, Purchases from Affiliates. All other information regarding purchases can be found in Operating Practice 112, Purchasing and Contracting Policies.
- 1.9 Oral contracts present substantial risks and should not be used for affiliate transactions. Non-affiliate oral contracts are discouraged except in very unusual circumstances involving minimal amounts of money. Employees entering into oral contracts must document the details of the contract within a short time after agreement is reached. This document should be signed and dated by the employee and, if possible, the other party's signature should be obtained.

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2.0 PURPOSE

- 2.1** The purpose of this Operating Practice is to establish the procedures to be followed by all departments of SWBT for contract administration and reporting of nontariffed activities provided under contract and to establish the policy for ensuring compliance with the FCC affiliate transaction accounting safeguards for purchases from and sales to affiliated companies.
- 2.2** This Operating Practice will assign responsibility for the elements of the contract process which include classification, assessment, costing, pricing, negotiation, and reporting for billing, accounting and cost and revenue tracking purposes. This Operating Practice also establishes the specific responsibilities, policy, activities and audit trail for sales to, and purchases from affiliates.
- 2.3** This Operating Practice describes the regulatory requirements for nontariffed activities provided under contract.
- 2.4** The general guidelines provided in this Operating Practice, and the Contract Coordinator and Departmental Contacts identified in the attachments, will facilitate the contract process and assist SWBT personnel entering into a contract to provide nontariffed activities to outside entities.

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3.0 DEFINITIONS

- 3.1 General - The definitions in this Operating Practice provide a common understanding for terms used in relation to contracts covering nontariffed activities that SWBT provides to outside entities, and in affiliate transactions.
- 3.101 Above-the-line - Revenues and expenses which net down to utility operating income as reported on the SWBT regulated books. This generally means revenues and expenses included in regulatory reporting.
- 3.102 Activities - Sales, leases, license agreements or any provision of services or products by SWBT in return for the receipt of any type of revenues, commissions or royalties.
- 3.103 Affiliate - Bell Communications Research, Inc. and any of its subsidiaries, any SWBT subsidiaries, Southwestern Bell Corporation (SBC), and all subsidiaries of SBC other than SWBT.
- 3.104 Affiliate Service - Any of several activities that SWBT performs internally that are provided to SBC and any of SBC's other subsidiaries exclusively utilizing primarily existing resources.
- 3.105 Affiliate Transaction - A transaction which includes assets and/or services being transferred or provided to SWBT from an affiliate or from SWBT to an affiliate.
- 3.106 Attributable Cost Method - The principal methodology adopted by the Federal Communications Commission (FCC) in CC Docket 86-111. This method is a forward-looking fully distributed costing methodology under which all costs with either a direct or indirect link to either regulated or non-regulated activities will be directly assigned to the appropriate activity. The remaining costs will then be apportioned between regulated and non-regulated activities. Cost causal attribution factors are used whenever possible, and the remaining costs are apportioned on the basis of a general allocator.
- 3.107 Below-the-line - Income and expenses reported below operating income on the SWBT books. This generally means revenues and expenses not allowed for regulatory reporting.

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- 3.108 Contract - Any document that memorializes Activities or Affiliate Transactions.
- 3.109 Contract Administrator - A departmental representative who has primary responsibility for the administration of a specific contract. Usually, the Contract Administrator is either the Product Manager, a Contract Manager or the Service Provider.
- 3.110 Contract Manager - A Procurement Contracting representative who may act as the Contract Administrator for a specific contract.
- 3.111 Cost Allocation Manual (CAM) - A manual prepared by SWBT that employs the cost allocation standards and guidelines adopted by the FCC to apportion costs between regulated telephone service and nonregulated activities. The CAM also includes affiliate transaction descriptions and costing methods. The CAM uses an attributable cost method. The CAM is filed with and approved by the FCC.
- 3.112 Deregulated - Those activities that are not subject to Title II regulation by the FCC or are no longer regulated by the state utility commissions and/or the FCC.
- 3.113 Detariffed - Those activities that were provided under state and/or FCC tariff, but are now provided without tariff, due to a change in the FCC or state rules.
- 3.114 Estimated Fair Market Value - A good faith estimate developed via methods routinely used by the general business community such as appraisals, catalog listings, competitive bids, replacement cost of an asset, net realizable value of an asset, sales to third parties, etc.
- 3.115 Fully Distributed Costing (FDC) - A costing methodology that requires all costs to be either directly assigned or apportioned to the Activities giving rise to those costs based on cost causation factors whenever possible, with the remaining costs apportioned on the basis of a general allocator.
- 3.116 Incremental Unit Costing (IUC) - A costing methodology that identifies the additional costs resulting from the provision of a new activity. Incremental cost studies, as currently performed by SWBT, may include direct costs that may be fixed or variable.

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- 3.117 Incidental - Those nontariffed Activities that have been traditionally provided as incidental to tariffed services, are an outgrowth of regulated operations, are not a separate line-of-business, and fall within the revenue limitation established by the FCC. The revenues of an Incidental activity, when aggregated with the revenues of other Incidental Activities, must not exceed one percent of total company annual regulated operating revenues.
- 3.118 Incidental InterLATA services - As defined in Section 271 of the Telecommunications Act of 1996, includes the following interLATA services which SWBT and SBC affiliates can provide, without a separate affiliate, to the extent that ratepayers or competition are not adversely affected.
- *Transmissions incidental to the provision of video, audio or other programming services to the public*
 - *Alarm monitoring*
 - *Interactive video and Internet services to schools*
 - *Commercial mobile services*
 - *Information storage and retrieval*
 - *Signaling information related to provision of exchange or exchange access services*
 - *Network control signaling information receipt and/or provision to other interLATA common carriers*
- 3.119 Non-discrimination Safeguards - The Telecommunications Act of 1996 provides that SWBT may not discriminate in favor of any 272 affiliate in the provision or procurement of goods, services, facilities and information, or in the establishment of standards.
- 3.120 Non-incidental - Those nontariffed Activities that are not Incidental. This could include Regulated services, Nonregulated services that are line-of-business activities, and those former Incidental activities that would cause SWBT Incidental revenues, in the aggregate, to exceed one percent of total company annual regulated operating revenues.

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- 3.121 Nonregulated - Those Activities that are not classified as common carrier communications services for purposes of Title II of the Communications Act of 1934, as amended. This includes preemptively deregulated services and excludes those activities classified as incidental.
- 3.122 Nontariffed - Those Activities that are not provided under either state or FCC tariff.
- 3.123 Nontariffed Regulated - Any of those activities that are not provided under either state or FCC tariff but receive regulated accounting and cost allocation treatment.
- 3.124 Operation, Installation, or Maintenance (OI&M) - A provision of the Telecommunications Act of 1996 by which SWBT and all SBC 272 affiliates are strictly prohibited from providing or in any way assisting in the operation, installation or maintenance of the other's network.
- 3.125 Outside Entity - Any corporate, civic or commercial organization other than Southwestern Bell Telephone Company or its affiliates.
- 3.126 Preemptively Deregulated - Those Activities that have been deregulated by the FCC in a manner that preempts state regulation.
- 3.127 Presumptively Prevailing - Services provided by SWBT to a 272 affiliate are not subject to the 50% threshold to establish prevailing price. Because the services provided by SWBT to the 272 affiliate must be provided to unaffiliated carriers in a non-discriminatory manner, the price is presumptively prevailing.
- 3.128 Prevailing Price - The price at which an entity actually provides a service or asset to the general public in a substantial number of transactions. As further defined for affiliate transaction purposes, Prevailing Price is established only if sales of a particular asset or service to nonaffiliated third parties encompasses greater than 50% of the total quantity of such product or service sold by an entity for the time period consisting of the current calendar year plus the prior calendar year.

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- 3.129 **Product Manager** - A Marketing representative responsible for the life cycle management of assigned products or services. The Product Manager may be appointed to act as a Contract Administrator for a specific contract.
- 3.130 **Regulated** - All Activities that are classified as common carrier communication services for purposes of Title II of the Communications Act of 1934, as amended. This includes state-deregulated basic services where the activities are reflected in interstate tariffed offerings and are detariffed or otherwise subjected to some form of deregulation in one or more states. Activities deregulated in the interstate jurisdiction that are not preemptively deregulated and items that are deregulated in the intrastate jurisdiction but are regulated in the interstate jurisdiction are also to be classified as Regulated. Activities classified as Incidental also receive regulated accounting and cost allocation treatment.
- 3.131 **Section 272** - *The section of the Telecommunications Act of 1996 which defines separate affiliate requirements for competitive activities. (See also "272 Affiliate" and "272 Oversight Team")*
- 3.132 **Service Provider** - A representative from the department that provides an Activity under contract to outside entities or affiliates. The Service Provider may act as the Contract Administrator.
- 3.133 **Tariffed** - Those Activities that are provided pursuant to documents filed with state or federal regulatory authorities. These documents (tariffs) contain terms and conditions under which the activity is provided, describe the activity and provide a method for determining the rates.

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- 3.134 **272 Affiliate** - A structurally separate affiliate as required by Section 272 of the Telecommunications Act of 1996 that engages in manufacturing activities, interLATA telecommunications services except those classified as incidental, or interLATA information services.
- 3.135 **272 Oversight Team** - Provides expedited review of all proposed affiliate transactions between SWBT and any subsidiary of SBC that is either currently operating under 272 structural separations rules or slated to do so in the future, in order to assure that the proposed transactions comply with the structural and transactional requirements and the non-discrimination safeguards. (Caution: Provision or receipt of interLATA services without prior review by the 272 Oversight Team could severely damage SBC's authority to offer interLATA services.)

Because SWBT is under legal obligation to provide a point of interface for our own 272 affiliates that is identical to that provided to unaffiliated third parties, there are two separate points of contact for this 272 Oversight Team:

- All requests from a 272 affiliate for SWBT products or services should be directed to the existing customer contact point appropriate for the service being ordered (BSC, CPAT, Regional Marketing, etc.)
- All other proposed affiliate transactions involving a 272 affiliate should be submitted by the close of business each Wednesday, in writing, to Mary Marks - Senior Attorney, in care of Corine Duft (cd4537@monmail.sbc.com) prior to provision or receipt of any service. Requests should contain a clear, concise statement of the facts, together with any supporting documentation which serves to better illuminate the request.

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4.0 REGULATORY REQUIREMENTS

- 4.1** All Nontariffed transactions between SWBT and outside entities must be treated in accordance with regulatory rulings to ensure that the SWBT regulated business activities are not subsidizing any other business activities. All such transactions are subject to scrutiny by federal and state regulators.
- 4.2** The FCC in CC Docket 86-111 initially set forth the rules for ensuring appropriate cost allocation treatment between Regulated and Nonregulated Activities, established limitations on Incidental Activities, and defined Affiliate Transaction accounting safeguards. *The rules governing affiliate transactions were amended in CC Docket 96-150.*
- 4.3** Part 64 of the FCC Rules and Regulations documents the cost allocation requirements established by the FCC. The CAM that SWBT has filed with the FCC complies with the provisions of Part 64. An annual CAM audit is performed to monitor compliance with the cost allocation requirements. *A biennial external audit of Section 272 affiliate transactions will be required and will include joint federal and state regulatory participation.*
- 4.4** Part 32 of the FCC Rules and Regulations includes instructions for the accounting treatment to be accorded to both Regulated and Nonregulated activities, including Nontariffed contract Activities and affiliate transactions. The SWBT Accounts Manual provides the detail necessary for appropriate SWBT reporting to ensure compliance with Part 32.
- 4.5** Part 36 of the FCC Rules and Regulations provides requirements for the handling of Activities in relation to the jurisdictional separations process.
- 4.6** Incidental InterLATA services must be accounted for on SWBT books and records as nonregulated activities. FCC notification requirements exist with respect to new nonregulated activity offerings.
- 4.7** The purpose of the sections that follow is to establish the procedures to be followed by all departments of SWBT for the contract administration of nontariffed activities provided under contract both to non-affiliated third parties and affiliates, and to establish the procedures necessary to assure compliance with the FCC affiliate transaction accounting safeguards for both sales to, and purchases from affiliates.

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- 4.8 Unique procedures may be required for the provision/receipt of nontariffed services or affiliate services to/from companies involved in merger activities with SBC and/or SWBT, such as the SBC merger with Pacific Telesis. See Attachment 3 for merger contact information to learn more about any such procedures.

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5.0 SERVICE CLASSIFICATION PROCESS FOR SALES TO AFFILIATES

Caution: No contract for a 272 affiliate can come through this process prior to legal and regulatory review by the 272 Oversight Team.

- 5.1 As soon as an employee becomes aware of a new or potential nontariffed SWBT service offering, a Letter of Notification must immediately be sent to the Cost Allocation Manual (CAM) contact for formal classification of the service as regulated nontariff, incidental or nonregulated. See Attachment 1, page 1 for details.
- 5.2 The service classification process occurs only once for each service unless there are significant changes in the service being offered. On the other hand, the contract classification process outlined below applies to all affiliate sales contracts. If the service to be offered is just another occurrence of a service that has already been classified and the buyer is not an affiliate, this Operating Practice is not applicable.
- 5.3 Once the CAM Contact has classified the service as regulated nontariff, incidental or nonregulated, enter the contract classification process as described in:

Section 6 for services that have been classified as regulated nontariff,

Section 7 for services that have been classified as incidental activities, and

Section 8 for services that have been classified as nonregulated.

Instead see Section 13-Affiliate Services, if the service is an existing service that is being performed within SWBT for SWBT in the normal course of business, and is being considered for offering to affiliates only.

These procedures ensure that 1) all affiliate contracts are reviewed by the Contract Coordinator and the CAM Attorney, 2) the SWBT CAM is updated as necessary, and 3) copies of the contracts are provided to the appropriate regulators, and 4) any necessary fully distributed cost studies and fair market value studies are completed, for previously classified services to be provided to an affiliate.

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- 5.4 Based on the information provided, the CAM contact will classify the service as Regulated, Nonregulated, or Incidental. If exception time reporting is required as in the case of Nonregulated services the CAM contact will provide the time reporting information.
- 5.5 Upon receipt of the service classification information from the CAM contact, the formal contract classification begins. The process for contract classification depends on the service classification as determined by the CAM contact.
- 5.6 Contract classification procedures are found in the following sections:
- Section 6 – Regulated Nontariff
 - Section 7 – Incidental
 - Section 8 – Nonregulated.
- 5.7 The department that negotiates the contract is responsible for appointing a Contract Administrator for the contract. Once the contract is negotiated, the department that is actually providing the service (Service Provider) must appoint a manager to assume the role of Contract Administrator and to perform the ongoing reporting and management oversight of the contract that will be necessary over the life of the contract.
- 5.8 The Contract Administrator is responsible for certain activities as defined in the following sections of this practice.

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6.0 REGULATED NONTARIFF CONTRACT CLASSIFICATION

Caution: No contract for a 272 affiliate can come through this process prior to legal and regulatory review by the 272 Oversight Team.

6.1 The classification of Regulated nontariff indicates that the service is one of the following types of activity:

- a. a common carrier communications service for purposes of Title II of the Communications Act of 1934, as amended;
- b. a common carrier offering subject to forbearance, streamlined or other decreased regulation;
- c. an Activity Regulated in the interstate jurisdiction that may be detariffed or deregulated in the states; or
- d. an Activity that is Deregulated only in one jurisdiction, and Regulated in the other jurisdiction. For example, if the activity is deregulated in the interstate jurisdiction and the deregulation is not preemptive.

6.2 A service may be classified both as regulated and as an affiliate transaction. Exceptions for treatment of affiliate transactions are noted in the following paragraphs of this section. Services provided only to affiliates are addressed in Section 13-Affiliate Services.

6.3 Upon classification of regulated by the CAM contact the Contract Administrator begins the contract classification process.

6.301 Step 1 Contract Assessment

For each potential contract, the new product, service or Activity must be assessed for marketability.

- a. Send the letter of request to the Marketing Assessment Address identified in Attachment 3.
- b. Provide a description of the product, service, or Activity.
- c. Describe the targeted market for the product, service or Activity.
- d. If the result of the assessment is to introduce a regulated nontariffed (contract) service, then contracts would be negotiated with the buyer. Negotiation is addressed later in this section.

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6.302 **Step 2 Cost Studies**

A cost study is required for each new or renegotiated contract for the provision of Nontariffed Activities. The cost study results will be provided to the Product Manager for use as a cost floor reference. For generic contracts and contracts where the pricing elements remain the same, one cost study will suffice.

- 1) The type of cost methodology used will be based on the classification of the contract.
 - a. For contracts with Nonaffiliated third parties that are classified as Regulated, an incremental unit cost study will be used as the cost floor reference for establishing the price.
 - b. For contracts with Affiliates, a Fully Distributed Cost study as promulgated in 47 C.F.R. 32.27 and 47 C.F.R. 64.901, will be used as the cost *comparison to an estimated fair market evaluation for those services for which a prevailing price does not exist. SWBT will record as revenue the higher of estimated fair market value and FDC. Estimated fair market value studies will be performed with the assistance of the Area Manager-Affiliate Services (Tom Powers, 314-235-9559) using unaffiliated third party price lists, quotes or a business research consultant's assistance. A prevailing price can only be established if more than 50% of an individual service or item quantity is sold to unaffiliated third parties. Documentation supporting the determination that a prevailing price is established must be provided to the Area Manager-Affiliate Services.*

(Note: State jurisdictions may have cost rules equivalent to or the same as a tariff for certain services. A legal review will assist in this determination.)
- 2) To request a cost study, a letter should be sent to the Cost Studies Request Address identified in Attachment 3. Questions may be referred to the Cost Studies Contact identified in Attachment 3. The following information is required.

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- a. Provide a description of the contract, the contract period, and a description of each pricing element (such as per unit, per month, per hour, etc.).
 - b. Provide all non-recurring cost elements (one-time and/or start-up) by state and the anticipated date the costs will be incurred.
 - c. Provide all recurring cost elements associated with capital investments; i.e., all equipment, account codes, installation hours, engineering hours, vendor fees, property tax and maintenance expenses (dollars or hours) by state and the anticipated date the costs will be incurred.
 - d. For labor efforts (recurring and non-recurring) provide the Responsibility Code (RC), the Job Function Code (JFC), the job level, the number of people and the hours required by state to perform the function. Also indicate how the time was determined (e.g., time and motion study, experience, etc.).
- 3) The Cost Studies organization will perform a cost study based on the classification of the contract.
- a. Cost Studies personnel may request additional information, as needed, from the Service Provider and/or the Contract Administrator.
 - b. Cost Studies personnel will develop the annual costs associated with the Activity including capital cost and operating expenses.
 - c. The cost study results for each pricing element will be provided to the Marketing Department to establish the price. The cost study can usually be completed within two months from the date of the request. This cost is considered to be the cost floor for establishing the price.
 - d. The cost study results may be provided to the Separations organization for their use if required.

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6.302 Step 3 Pricing

The pricing of specific contract Activities is normally done by the Marketing organization *unless the contract is with an affiliate, then the Area Manager-Affiliate Services should be contacted*. Regulated nontariff service pricing for nonaffiliate services is coordinated through the Rates organization. Three basic factors are considered when determining price: market value, service value and cost recovery.

- a. Market value is a primary factor in setting price. If a comparable service, product or activity exists in the open marketplace, the price should be set in relation to that market price.
- b. If a market comparable is not available, service value can be used in setting the price. The value of a service, product or Activity may be what the customer is willing to pay or what it would cost the customer to perform the service internally.
- c. However, both market value and service value pricing must recover cost as determined by the cost studies group and should allow for a reasonable contribution. *The higher of estimated fair market value and FDC will be recovered for services provided to affiliates if prevailing price criteria are not met. A prevailing price can only be established if more than 50% of an individual service or item quantity is sold to unaffiliated third parties. Documentation supporting the determination that a prevailing price is established must be provided to the Area Manager-Affiliate Services.*

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- 6.303 **Step 4 Negotiation**
For each contract, coordination must occur between the Buyer, the Service Provider and either the Product Manager or a Contract Manager to negotiate terms for a formal contract. Negotiation assistance and guidance is available from the Marketing and Legal Departments and where appropriate, the Procurement Department. Specifically, the group that sets the price for a particular service can provide contract negotiation or recommendations on contract content. Prior to signing, all contracts are required to be submitted for legal review, as indicated below.
- 6.304 **Step 5 Legal Review**
Each Contract Administrator must forward to the appropriate state or Headquarters Legal Department the contract for review before the contract is signed. If the contract covers an affiliate transaction, the CAM Attorney must also review the contract prior to signing.
- 6.305 **Step 6 Contract Signing**
Upon return from legal review and if necessary the CAM Attorney review, the Contract Administrator must obtain the appropriate signatures of the buyer and SWBT (according to the Schedule of Authorizations).
- 6.306 **Step 7 Prepare SW-1161**
Immediately after the contract is signed the Contract Administrator must prepare the SW-1161 as described in Attachment 1. The SW-1161 is forwarded to the Contract Coordinator listed in Attachment 2 for formal classification. A copy of the signed contract must be attached to the SW-1161.
- 6.307 **Step 8 Formal Classification**
The Contract Coordinator will review the contract and sign the SW-1161 indicating concurrence with the classification of the activity as noted on the SW-1161.
- 6.308 **Step 9 Classification Attorney Review**
The Contract Coordinator must obtain appropriate Legal Department representative signature indicating that he/she has reviewed the contract and agrees with the classification.

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- 6.309 **Step 10 Accounting Classifications**
Upon return of the SW-1161 with the proper signatures as defined in steps 8 and 9, each Contract Administrator must coordinate with the Contract Coordinator (see Attachment 2) who will contact Accounting Classifications, when necessary, to ensure that the proper account classifications are determined for financial reporting purposes.

The accounting for Regulated Nontariffed Activities provided under contract is consistent with Regulated Activities provided under federal or state tariffs. All expenses are charged directly to the appropriate expense accounts as incurred. The revenues from these services are credited to the appropriate revenue accounts consistent with the recording of revenues for similar services under tariff.

- 6.310 **Step 11 Reporting & Tracking**
Each Contract Administrator will determine the appropriate tracking system and must ensure that the details of the ongoing contract Activities are provided by the Service Provider to the appropriate billing and tracking systems. If the service is provided to affiliates as well as nonaffiliates, the Contract Administrator must coordinate with the Contract Coordinator to establish procedures for tracking the affiliate transactions for regulatory reporting. Reporting for the billing and tracking of contract Activities provided by SWBT is reported to the Comptrollers office through the following accounting processes:

Billing for contracts classified regulated non-tariff is through CRIS, CABS, or revenue special billing.

- 6.4 The contracts that have been classified regulated nontariff and affiliate transaction via Form SW-1161 will be used by the Contract Coordinator in updating the SWBT CAM filed with the FCC.
- 6.5 **Separations Treatment** Each Contract Administrator must provide information as requested by the Separations organization for fulfilling FCC requirements for appropriate Separations treatment. Questions may be referred to the Separations Contact listed in Attachment 3.

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- 6.6 Review Each contract should be reviewed by the Contract Administrator on an annual basis to determine if there have been any changes that may require the contract to be reentered into the classification process.
- 6.7 Cancellation If a contract is cancelled, the Contract Administrator should write "CANCELLED on (date)" in red ink at the top of the original SW-1161, and return the form to the Contract Coordinator. In addition, the Contract Administrator must ensure that the ongoing reporting associated with the contract Activities is terminated appropriately.

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7.0 INCIDENTAL ACTIVITIES CONTRACT CLASSIFICATION

Caution: No contract for a 272 affiliate can come through this process prior to legal and regulatory review by the 272 Oversight Team.

- 7.1 The classification of Incidental Activity indicates that the service is considered:
 - a. An outgrowth of Regulated operations; and
 - b. a non-line-of-business Activity; and
 - c. has been traditionally treated as Incidental. (Listed in Section 3 of the SWBT CAM)
- 7.2 A service may be classified as both an Incidental Activity and an affiliate transaction. Exceptions to Incidental treatment for affiliate transactions are noted in the following paragraphs. Services provided only to affiliates are addressed in Section 13-Affiliate Services.
- 7.3 Upon classification as an incidental activity by the CAM contact the contract administrator begins the formal classification process.
 - 7.301 **Step 1 Assessment**
For each contract, the new service or Activity must be assessed for marketability.

A letter of request for the assessment of a new product, service or Activity should be handled as follows:
 - a. Send the letter of request to the Marketing Assessment Address identified in Attachment 3.
 - b. Provide a description of the service, or Activity.
 - c. Describe the targeted market for the product, service or Activity.
 - d. If the result of the assessment is to introduce an incidental activity (contract) service, then contracts would be negotiated with the buyer.

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7.302 Step 2 Cost Study

A cost study is required for each new or renegotiated contract for the provision of Incidental Activities. The cost study results will be provided to the Product Manager for use as a cost floor reference. For generic contracts and contracts where the pricing elements remain the same, one cost study will suffice.

- 1) The type of cost methodology used will be based on the classification of the contract.
 - a. For contracts with Nonaffiliate third parties that are classified as Incidental Activity, an incremental unit cost study will be used as the cost floor reference for establishing the price.
 - b. For contracts with Affiliates, a Fully Distributed Cost study as required by the FCC rules as promulgated in 47 C.F.R., Part 32.27 and 47 C.F.R., Part 64.901 will be used as the cost comparison to an estimated fair market evaluation for those services for which a prevailing price does not exist. *SWBT will record as revenue the higher of estimated fair market value and FDC. Estimated fair market value studies will be performed with the assistance of the Area Manager-Affiliate Services (Tom Powers, 314-235-9559) using unaffiliated third party price lists, quotes or a business research consultants's assistance. A prevailing price can only be established if more than 50% of an individual service or item quantity is sold to unaffiliated third parties. Documentation supporting the determination that a prevailing price is established must be provided to the Area Manager-Affiliate Services.*
- 2) To request a cost study, a letter should be sent to the Cost Studies Request Address identified in Attachment 3. Questions may be referred to the Cost Studies Contact identified in Attachment 3. The following information is required.

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- a. Provide a description of the contract, the contract period, and a description of each pricing element (such as per unit, per month, per hour, etc.).
 - b. Provide all non-recurring cost elements (one-time and/or start-up) by state and the anticipated date the costs will be incurred.
 - c. Provide all recurring cost elements associated with capital investments; i.e., all equipment, account codes, installation hours, engineering hours, vendor fees, property tax and maintenance expenses (dollars or hours) by state and the anticipated date the costs will be incurred.
 - d. For labor efforts (recurring and non-recurring) provide the Responsibility Code (RC), the Job Function Code (JFC), the job level, the number of people and the hours required by state to perform the function. Also indicate how the time was determined (e.g., time and motion study, experience, etc.).
- 3) The Cost Studies organization will perform a cost study based on the classification of the contract.
- a. Cost Studies personnel may request additional information, as needed, from the Service Provider and/or the Contract Administrator.
 - b. Cost Studies personnel will develop the annual costs associated with the Activity including capital cost and operating expenses.
 - c. The cost study results for each pricing element will be provided to the Marketing Department to establish the price. The cost study can usually be completed within two months from the date of the request. This cost is considered to be the cost floor for establishing the price.
 - d. The cost study results may be provided to the Separations organization for their use if required.

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7.303 Step 3 Pricing

The pricing of specific contract Activities is normally done by the Marketing organization *unless the contract is with an affiliate, then the Area Manager-Affiliate Services should be contacted*. Regulated service pricing for nonaffiliate incidental services is coordinated through the Rates organization. Three basic factors are considered when determining price: market value, service value and cost recovery.

- a. Market value is a primary factor in setting price. If a comparable service, product or activity exists in the open marketplace, the price should be set in relation to that market price. *If the Incidental activity is similar to a tariffed activity, the tariffed rate may be a primary price determinant.*
- b. If a market comparable is not available, service value can be used in setting the price. The value of a service, product or Activity may be what the customer is willing to pay or what it would cost the customer to perform the service internally.
- c. However, both market value and service value pricing must recover cost plus some reasonable contribution. In the case of services to affiliates the *higher of estimated fair market value and FDC must be recovered if the prevailing price criteria is not met. A prevailing price can only be established if more than 50% of an individual service or item quantity is sold to unaffiliated third parties. Documentation supporting the determination that a prevailing price is established must be provided to the Area Manager-Affiliate Services.*

7.304 Step 4 Negotiation

For each contract, coordination must occur between the Buyer, the Service Provider and either the Product Manager or a Contract Manager to negotiate terms for a formal contract. Negotiation assistance and guidance is available for the Marketing and Legal Departments and where appropriate, the Procurement Department. Specifically, the group that sets the price for a particular service can provide contract negotiation or recommendations on contract content. Prior to execution, all contracts are required to be submitted for legal review.

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- 7.305 **Step 5 Legal Review**
Each Contract Administrator must forward to the appropriate state or Headquarters Legal Department each contract for review before the contract is signed. *For contracts with affiliates, the CAM Attorney must also review the contract prior to signing.*
- 7.306 **Step 6 Contract Signing**
Upon return from legal review the Contract Administrator must obtain the appropriate signatures of the buyer and SWBT (according to the Schedule of Authorizations).
- 7.307 **Step 7 Prepare SW-1161**
The Contract Administrator must prepare a SW-1161 as described in Attachment 1. The Contract Administrator must forward the SW-1161 to the Contract Coordinator listed in Attachment 2 to obtain the formal classification. A signed copy of the contract must be attached to the SW-1161.
- 7.308 **Step 8 Formal Classification**
The Contract Coordinator will review the contract and sign the SW-1161 to indicate agreement with the classification as noted on the SW-1161.
- 7.309 **Step 9 CAM Attorney Review**
The Contract Coordinator must obtain the signature of the CAM Attorney on the SW-1161 to indicate concurrence with the classification of the incidental service contract.
- 7.310 **Step 10 Accounting Classifications**
Each Contract Administrator must coordinate with the Contract Coordinator (see Attachment 2) who will contact Accounting Classifications, when necessary, to ensure that the proper account classifications are determined for financial reporting purposes.
- Expense and revenue accounting for Incidental Activities provided under contract is consistent with Regulated Activities provided under federal or state tariffs.*

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7.311 **Step 11 Reporting and Tracking**

Each Contract Administrator will determine the appropriate tracking system and must ensure that the details of the ongoing contract Activities are provided by the Service Provider to the appropriate billing and tracking systems. If the Incidental Activity contract is for a service to be provided to Affiliates the Contract Administrator must coordinate with the Contract Coordinator listed in Attachment 2 to establish procedures for tracking the Affiliate Transactions for regulatory reporting. A list of the Incidental Activities and the Contract Administrators is provided in Attachment 4. Reporting for the billing and tracking of contract Incidental Activities provided by SWBT is reported to the Comptroller's office through one of the following accounting processes:

- a. Revenue special billing is the methodology for contracts classified as Incidental (including incidental contracts with the affiliates) except as noted in b.
- b. The Technical Services Billing System *may be used* for billing to Affiliates for *certain* incidental services.

7.4 Annual operating revenues from all Nontariffed Activities classified as Incidental cannot exceed, in the aggregate, one percent of total company annual Regulated operating revenues. The Contract Administrator for each Nontariffed Activity is responsible for tracking the Incidental revenues and for reporting the total annual revenues for each Incidental Activity to the *Contract Coordinator*. On an annual basis, when the aggregate revenue information is needed for FCC reporting, the *Contract Coordinator* will initiate a request to the Incidental Activities Contract Administrators for reporting the total annual revenues associated with each Incidental Activity.

7.5 The contracts that have been classified via Form SW-1161 will be used by the Contract Coordinator in updating the SWBT CAM filed with the FCC.

7.6 **Separations Treatment** Each Contract Administrator must provide information as requested by the Separations organization for fulfilling FCC requirements for appropriate Separations treatment. Questions may be referred to the Separations Contact listed in Attachment 3.

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